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SUBJECT: GOI SEEKS MORE BANG FOR THE BUCK FROM SHRINKING
DEFENSE PROCUREMENT

REF: ROME 28

¶1. (U) Summary: Facing budget cuts and a stagnant economy, the Government of Italy (GOI) will seek to leverage its defense spending to continue to gain access to cutting edge technologies as part of a broad effort to revive the Italian economy. The amount of technology transfer and job creation resulting from Italian participation continues to weigh heavily on defense procurement decisions. For example, the USG's recent approval of a final assembly and check-out facility (FACO) for the JSF being located near Turin, Italy, should weigh very heavily in favor of Italy's continued robust participation in the JSF program. GOI disappointment in the outcomes of some previous technology transfer agreements ensures close scrutiny of future projects. End Summary.

Slow Economic Growth Puts Pressure on Military Budget

¶2. (U) Italy's economy has eked out average real GDP growth of 0.74 percent over the past five years. GDP growth in 2005 was 0.2 percent, with growth of 1.25 percent projected for 2006. Anemic economic growth, combined with EU Stability and Growth Pact deficit caps, has resulted in downward pressure on Italy's defense operations budget. As reported reftel, the 2006 budget cuts defense operations funding from 13.6 billion euro (0.99 percent of GDP) to 12.9 billion euro (0.90 percent of GDP). Funding for multi-year programs and investments remained relatively flat, and included a plus-up of 55 million euro annually for Major International and Interforce Programs⁸ through 2020. However, budget constraints mean that any projects not already under contract are at risk.

Government Looks to Military Programs for Jobs

¶3. (U) According to MOD and defense industry contacts, economic and budgetary pressures are causing the GOI to look for ways in which defense spending can promote economic growth and increase Italy's technological edge. The GOI wants defense contracts to create jobs and provide work for underutilized existing employees. This has long been an Italian government/defense industry strategy, but has become more prominent in the face of increased budget pressures and economic stagnation.

Aerospace Industrial Basins

¶4. (U) In an effort to facilitate increased economic activity, the Italian Association for Aerospace Industry (AIAD) is working with the Ministry of Productive Activities (MPA) to identify aerospace plants which can form the heart of Industrial Basins.⁸ AIAD's goal is to create industrial centers that will enable the companies there to

capitalize on concentrations of knowledge and skilled labor. Industrial basins identified by AIAD include:

- Varese, concentrated around the Agusta helicopters plant;
- Turin, concentrated around the plants of the Avio, Alenia Spazio and Areonautica Galileo companies;
- Rome, concentrated around Agusta,s administrative offices and factory in Frosinone;
- Naples, concentrated around Avio, Italy's largest engine manufacturing company;
- Brindisi, concentrated around the Agusta factory; and
- Genoa, concentrated around Piaggio,s engine manufacturing facility.

¶5. (U) Non-aerospace projects are making substantial contributions to the economies of Liguria (FREMM Frigate), Puglia and Piedmonte (EuroFighter and NH-90 Helicopter), Tuscany (C-130J maintenance).

Industry Association Bullish on U.S.-Italy Defense Partnership

¶6. (U) AIAD is optimistic that additional U.S./Italian defense industry partnerships will follow Agusta Westland/Lockheed Martin,s successful bid for the US-101 helicopter for U.S. Presidential airlift support, which gave the Italian defense industry entry into what had been a U.S.-only market.

¶7. (U) Partnerships like the Agusta Westland/Lockheed Martin joint venture are changing the way Italian defense companies do business by proving that Italian businesses profit from joint ventures with U.S. companies. The successful collaborations between L-3 Communications and Alenia (C-27J small cargo aircraft) and Northrop Grumman and

European Aeronautic Defence and Space (EADS) (KC-30 Tanker) are additional examples of partnerships that won internationally competitive defense contracts. These partnerships are helping overcome the perception that, despite their high quality aerospace products, Italian companies lack the capacity to provide adequate follow-on support. They also prove that the difficulties associated with previous European and U.S. joint ventures (A-400 Cargo Aircraft, FREMM, C-130J, etc.) can be the exception rather than the rule.

. . . But GOI/Industry Group Not So Sanguine

¶8. (C) In contrast to AIAD,s optimism, the GOI/industry delegation to meetings with the U.S. Interagency Team on Offsets expressed their disappointment in the United States for not fulfilling its offset commitments and cast doubt on future collaboration. They cited shortfalls to offset commitments in the F-16 lease and the C-130J and B-767 Tanker purchase as examples. Camillo Pirozzi of Finmeccanica made known Finmeccanica,s disappointment in the amount of technological transfer that will result from Italian participation in JSF. He stated that future investment in the EuroFighter is a viable option because it offers production and technology transfer benefits not present in the JSF program.

Comment: Caution Ahead

¶9. (U) Comment. In the past, Italian defense companies have been accused of favoring U.S. companies to the detriment of European companies or joint EU projects. The tide seems to have shifted, and there is a perception on the part of Italian defense companies that despite strong funding by the GOI, opportunities for Italian corporate participation in joint defense projects are not commensurate with the level of GOI financial involvement. Given the GOI,s apparent desire to use defense contracts to promote technology transfers and economic growth, it is conceivable that future joint projects such as the C-17 and Joint Surveillance Command Program

(JSCP) could be scaled back or cut unless the GOI and Italian industry are confident that the economic benefits of participation outweigh the costs.

¶10. (U) Comment Continued. The USG has a strong interest in ensuring continued Italian participation in joint defense projects such as the JSF and Medium Extended Air Defense System (MEADS). Italian deployments in Iraq, Afghanistan, and the Balkans illustrate the importance of interoperability between the U.S. and Italian militaries. The Embassy will continue to seek opportunities to engage the GOI and Italian industry on this issue, using events such as the visit of the Interagency Team on Offsets to their maximum effect. End comment.
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